



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

The recurring problem of nonrecurring revenue

Oklahoma's budget has become more and more dependent on one-time funding sources and other one-time fixes in times of both economic contraction and expansion.

This coming legislative session promises to be no different. One question this time is whether there will be enough nonrecurring revenue to avoid debilitating cuts in core services Oklahoma's businesses and citizens depend upon, or has the well begun to run dry? Another is whether core services are adequately funded today?

During times of economic downturn, such as during the Great Recession and

in what appears to be the case in the coming legislative session, temporary suboptimal budget practices can be justified. But when such practices continue unabated during economic growth cycles, the problems are exaggerated when things turn bad.

How we got here

During the Great Recession, the state delayed payment of tax incentives and took money from revolving funds and other accounts such as the Unclaimed Property Fund to make ends meet. But when the economy recovered, reliance on nonrecurring revenue sources continued.

In FY-12, almost \$400 million of nonrecurring funds helped grow the budget by five percent over the prior year. In FY-13, even as the economy continued to expand, nearly \$300 million in one-time money was used in the budget.

In FY-14, budget writers worked to phase out over a two-year period the use of one-time funds and reduced use of those funds to \$126 million.

But during the next year, nearly \$292 million was included in the FY-15 general appropriations bill, making it larger than the prior year's.

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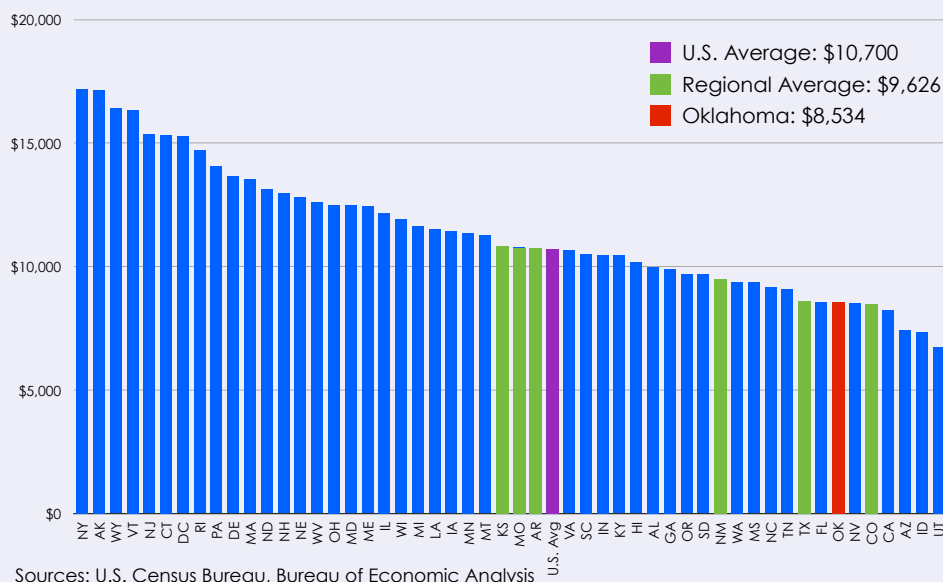
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Core Funding: Common Education Spending per Pupil

FY-13 from all sources, price parity adjusted





Treasurer's Commentary By Ken Miller, Ph.D.

Nonrecurring nightmares

The billion dollar question that has persisted for months around the state capitol is soon to be answered. On December 21, fiscal policymakers will have their first official estimate of funds available for fiscal 2017 appropriations. Until November revenues are baked into the projection, no one is certain of the estimate – but we do know it will be less than last year and that much of the problem is self-inflicted.

Throughout the Great Recession, suboptimal financial practices, like using one-time revenue sources, had to be employed to deliver core services to our citizens. Unfortunately, reliance on nonrecurring revenue to balance the budget did not subside when the economy recovered to full employment. In fact, the appetite has only grown, resulting in state budgets that are constitutionally balanced, yet structurally imbalanced.

The state budget has become dependent on using one-time funds in both good times and bad. Oklahoma's economy has expanded for the last several years, yet more than \$1 billion in nonrecurring revenues have been tapped during that period to spend more than the certified amount.

Using such large amounts of

alternative revenues to prop up the state budget is de facto admittance by policymakers that there is insufficient revenue to fund their desired level of government spending.

Outside of government, it is well accepted that nonrecurring revenues should not be used for ongoing expenditures and that recurring revenue streams should not be cut when current costs exceed them. Yet under the capitol dome that has become standard operating procedure and changes shouldn't be expected next session given the expected severity of the shortfall.

“Common sense dictates that until the state proves it can live within its means, it really should stop reducing them.”

Common sense dictates that until the state proves it can live within its means, it really should stop reducing them, yet some “thinkers” continue to advocate eliminating the state income tax – even arguing that the state's largest funding source can be



vanished without a replacement and still fund needed teacher pay raises. This contention would be laughable if not so devastatingly irresponsible – considering current funding status of core services. But rather than rebuke this nonsense, many in positions of responsibility actually enable it through their silence or rhetoric.

Rather than focus solely on lowering the income tax, Oklahoma should modernize our entire outdated tax structure, which was built for an economy that no longer exists. The ideal tax structure would broadly apply low rates to generate a stable and diversified revenue stream that does not unfairly burden property owners, discourage consumption or reward idleness and retains the profit motive that drives entrepreneurship.

More immediately, any additional tax cuts should be revenue neutral. If policymakers want to further reduce the income tax, they must

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Commentary

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adopt a “pay-as-we-go” approach by eliminating one dollar of spending or credits for every dollar cut in taxes.

Improvements have been made, but even greater prioritization and

operating efficiencies can be found. Those left on the table will require hard-fought battles against an entrenched status quo.

Just as fiscal stewards did by

correcting suboptimal pension practices, with increased realization of the structural budgeting problems, policymakers can begin the difficult process of weening our state off its dependency.

Problem

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When the time came to write the FY-16 budget earlier this year, legislators once again filled the budget hole with one-time revenue and other short-term fixes.

Early indications of what's coming

Three primary factors led to last session's \$611 million estimate reduction – subtraction of one-time revenue sources used the prior year, the downturn in energy prices, and the fiscal impact of reducing the top income tax rate by 0.25 percentage points.

On December 21, the State Board of Equalization will meet to certify a preliminary estimate of revenue for FY-17. The certified preliminary estimate will be used by Governor Fallin in proposing a budget to the Legislature when it convenes on February 1.

The final revenue estimate to be used to craft the budget will be certified by the board later in February.

The FY-17 estimate will subtract the nonrecurring revenue used in the FY-16 budget and will take into account the

ongoing oil price situation and the full-year impact of the tax cut.

When the final revenue estimate was made last February, indications were that oil prices would begin to rebound by the end of this calendar year and thus would not present a big challenge to the FY-17 budget.

The outlook has darkened since then with the U.S. Energy Information Administration's November Short-Term Energy Outlook report projecting continued low prices and production levels through most of the next year with perhaps a slight rebound by the end of the calendar year.

The change in oil price projections will undoubtedly have an impact on the upcoming fiscal year estimate. In addition, the ongoing energy downturn is already being seen in current fiscal year collections.

Gross Receipts to the Treasury are showing both the direct and indirect impact of the slowdown with monthly collections indicating economic contraction for six consecutive months.

Twelve-month collections are currently the lowest in 16 months.

The picture of the General Revenue Fund, the state's main operating account that receives about half of gross receipts, is also showing

signs of strain. With fiscal year-to-date allocations 2.8 percent below the estimate, the specter of a revenue failure during the current fiscal year is now considered a possibility.

A revenue failure would be issued if current collections come in less than 95 percent of the estimate, since that is the constitutionally-allowed funding

“Is there enough nonrecurring revenue to avoid debilitating cuts in services, or has the well begun to run dry?”

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Problem

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limit. Across-the-board spending cuts to all appropriated agencies would then follow.

In late October, the governor issued executive orders calling on state agencies to begin curtailing spending.

Caring for the Core Four

Education, public safety, health and transportation are the core four government services. Whether they are adequately provided determines to a large extent the success of the state's economy.

Core service funding alone isn't an absolute indicator of success or failure, but it is a fundamental component. Of course, other factors measuring performance and outcomes are also important. Determining whether funding is sufficient is open to debate, even when considering cost of living differences between the states, but a relative comparison of the Core Four shows Oklahoma lags behind much of the nation.

U.S. Census Bureau data, adjusted for cost parity using Bureau of Economic Analysis figures, show Oklahoma is seventh from the bottom in the nation and the second lowest in the region for per pupil funding of primary and secondary education from all revenue sources in FY-13.

After adjusting per enrollee spending on Medicaid for price parity, Oklahoma ranks eighth from the bottom in the nation and in last place of the states that border us. The most recent data available, from FY-10, ranks Oklahoma Medicaid spending 20 percent below the

regional average and 12 percent below the national average.

Price parity adjusted per capita state and local spending for police and corrections lists Oklahoma as spending five percent less than the regional average and 12 percent less than the national average.

State and local spending per lane mile on highways, price parity adjusted, shows Oklahoma seven percent lower than the regional average and 44 percent below the national average. This comparison from FY-13 comes during a concerted effort for the past several years to increase transportation funding in the state.

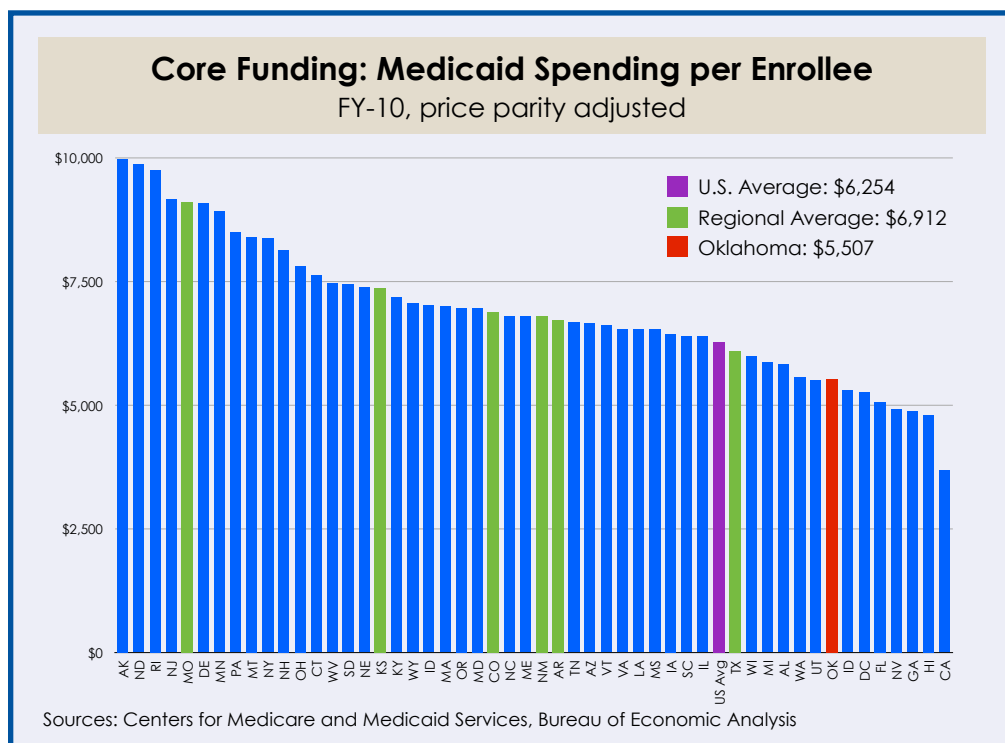
Making changes

Greater efficiencies can still be found to lower costs and improve core service

delivery, but the remaining options are difficult –both operationally and politically – and that is likely why they haven't yet been done.

This coming legislative session will likely be conducted in crisis mode as policymakers struggle to find any way possible to avoid large service cuts. Perhaps the hard work of correcting the structural imbalance of the state budget will have to wait until the economy grows stronger.

Exactly when this problem will be addressed remains to be seen, but addressed it must be. Eventually, policymakers must start down a path toward long-term sustainability, rather than cobble together more short-term fixes that leave the same problems for future legislatures – until the one-time revenue well runs dry.





General Revenue Fund collections slip below estimate

Year-to-date allocations to Oklahoma's General Revenue Fund (GRF) are below the estimate by \$51.8 million, or 2.8 percent, the Office of Management and Enterprise Services (OMES) announced in November.

The variance between year-to-date collections and the estimate dropped by 2.5 percentage points over the month with the inclusion of October data,

which fell to \$47.3 million, or 10.2 percent below the monthly estimate.

For the first four months of FY-16, only one revenue stream is listed as exceeding the estimate. Net income tax collections of \$819.9 million are ahead of the estimate by \$117.9 million, or 16.8 percent.

Gross production tax allocations total

\$39 million, which are below the estimate by \$58.2 million, or 59.9 percent.

Sales tax collections are shown as \$645.9 million, below the year-to-date estimate by \$70.6 million, or 9.9 percent.

Motor vehicle allocations to the GRF are \$69.9 million, falling \$10.3 million or 12.8 percent below expected receipts, according to OMES.

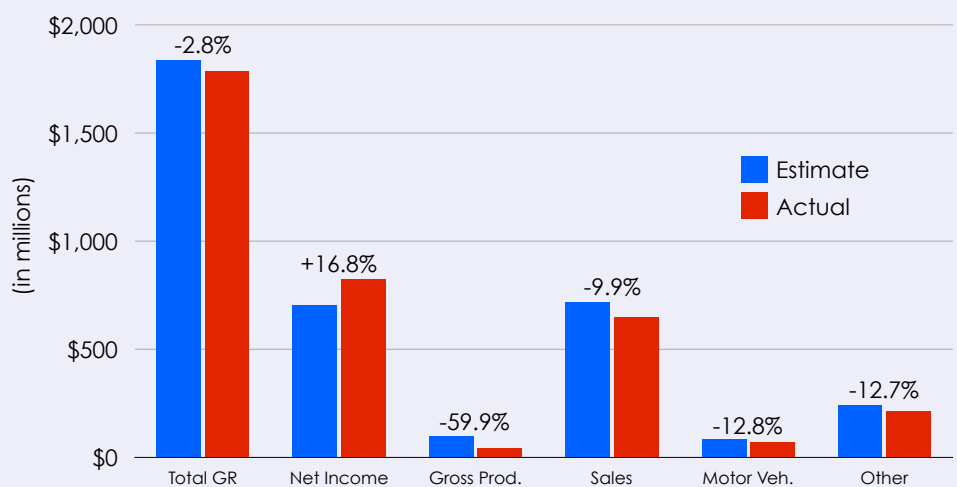
All remaining revenue allocated to the GRF totals \$209.5 million, which is less than the estimate by \$30.6 million, or 12.7 percent.

Within the past month, Governor Mary Fallin has issued executive orders designed to curtail spending by state government agencies. In addition, Preston Doerflinger, Cabinet Secretary for Finance, Administration and Information Services, has issued statements raising the possibility of a revenue failure during the current fiscal year.

The GRF is the state's main operating fund and receives slightly less than one-half of Gross Receipts to the Treasury.

General Revenue Fund Collections vs. Estimate

FY-16 through October



Source: Office of Management and Enterprise Services

Miller elected Senior VP of national treasurers' association

State Treasurer Ken Miller was selected by his peers as Senior Vice President of the National Association of State Treasurers (NAST) at the group's annual meeting in October.

As Senior Vice President, Miller is one of three officers chosen by the nation's state treasurers to lead its association.

He was the only candidate nominated for the position and was elected by acclamation.

Miller previously served as NAST secretary-treasurer and Southern Region Vice President. For the last three years he has served as chairman of the NAST Foundation, where he spearheaded the

resurrection of the National Institute of Public Finance to provide cutting edge training for public treasury officials and staff.

NAST provides advocacy and support that enables member states to pursue and administer sound financial policies and programs.



Gross Receipts & General Revenue compared

October Gross Receipts to the Treasury totalled \$918.1 billion, while the General Revenue Fund (GRF), as reported by the Office of Management and Enterprise Services, received \$415 million, or 45.2% of the total.

The GRF received between 35.7% and 53.6% of monthly gross receipts during the past 12 months.

From October gross receipts, the GRF received:

- Personal income tax: 58.6%
- Corporate income tax: None
- Sales tax: 45.1%
- Gross production-Gas: 63.7%
- Gross production-Oil: 1.5%
- Motor vehicle tax: 27.2%
- Other sources: 33%

October GRF allocations are below the estimate by \$47.3 million or 10.2%. Fiscal year-to-date collections are less than the estimate by \$51.8 million or 2.8%.

October insurance premium taxes totaled \$385,344, an increase of \$187,825, or 95.1%, from the prior year.

Tribal gaming fees generated \$10.65 million during the month, up by \$454,081, or 4.5%, from last October.

All Major Revenue Streams Shrink in October Gross Receipts to the Treasury

For a sixth consecutive month, Gross Receipts to the Treasury are lower than the same month of the prior year as every major revenue stream

shows contraction in October, State Treasurer Ken Miller announced today.

Twelve-month Gross Receipts to the Treasury also reflect an economic pullback as collection totals are the lowest in 16 months.

“The spillover effect of low oil prices is seen throughout October’s report,” Miller said. “This is the first month that all major revenue streams have shown contraction since we began tracking Gross Receipts to the Treasury in March of 2011.”

Total Gross Receipts to the Treasury for October are \$918.1 million, down by more than \$95 million, or 9.4 percent, from October 2014.

“The spillover effect of low oil prices is seen throughout October’s report.”

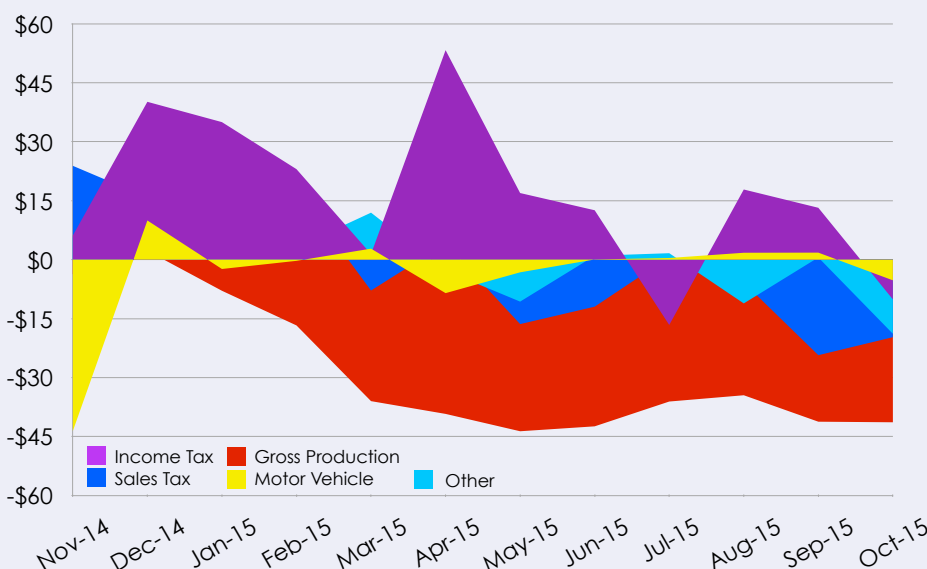
As has been the case in 11 of the past 12 months, collections from oil and natural gas production taxes are down significantly for the month. October

gross production collections are more than 56 percent lower than last October. Monthly receipts reflect oil field activity from August when the average price of benchmark West Texas Intermediate crude oil was \$42.87 per barrel.

Motor vehicle tax collections are down by almost 8 percent for the month, while

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Monthly Gross Receipts vs. Prior Year



Dollar change (in millions) from prior year

Source: Office of the State Treasurer



Revenue

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sales tax collections are off by more than 5 percent, and gross income taxes are down by more than 3 percent.

Personal income tax receipts are below last October's collections by more than 4 percent, while corporate income tax receipts, which often vary widely from

month to month, are up by more than 23 percent.

Total 12-month collections are \$11.76 billion, down by \$188.8 million, or 1.6 percent from the trailing 12-month period.

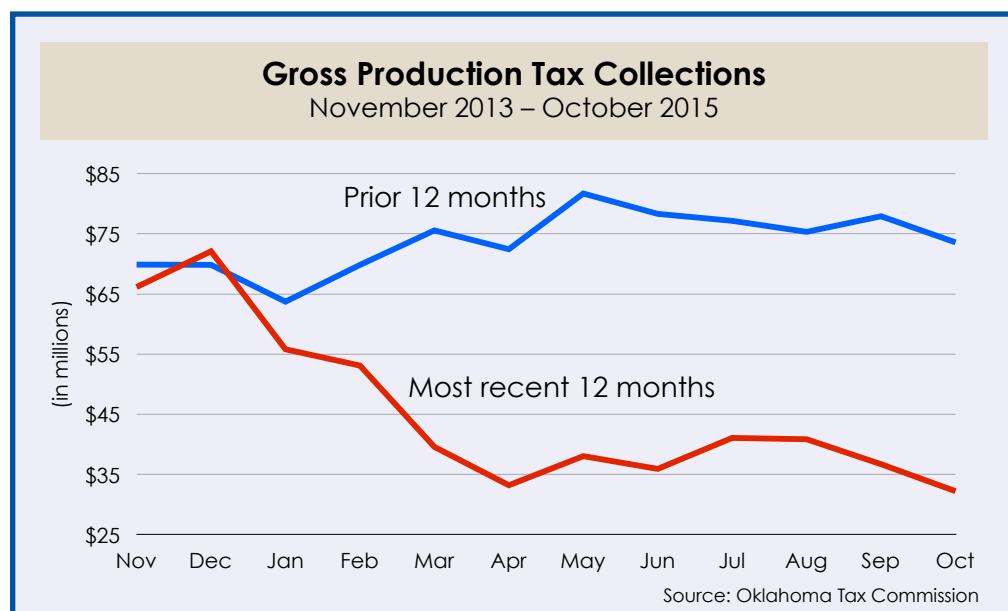
During the 12 months, gross production tax collections are down by more than 38 percent and motor vehicle collections are off by almost 6 percent. Even though they are trending downward, gross income tax and sales tax collections remain growth positive over the 12 months.

About Gross Receipts to the Treasury

Since March 2011, the Treasurer's Office has issued the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state's macro economy.

It is provided in conjunction with the General Revenue Fund (GRF) allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

The GRF receives just less than half of the state's gross receipts.



Oklahoma jobless rate ticks down slightly in October

Oklahoma's seasonally-adjusted unemployment rate was set at 4.3 percent in October, down by one-tenth of one percentage point from September, according to the Oklahoma Employment Security Commission.

Over the past year, Mining & Logging (including the energy sector) reported the loss of 11,600 jobs, while Manufacturing showed a reduction of 8,900 jobs.

The national unemployment rate was set at 5.0 percent in October.

Oklahoma Unemployment Report September 2015				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Oct '15	4.3%	1,839,491	1,761,282	78,209
Sept '15	4.4%	1,837,396	1,756,414	80,982
Aug '15	4.6%	1,842,978	1,759,061	83,917
July '15	4.5%	1,853,564	1,769,665	83,899
June '15	4.5%	1,862,461	1,779,424	83,037
May '15	4.3%	1,863,285	1,783,101	80,184
Oct '14	4.1%	1,780,675	1,707,964	72,711

* Data adjusted for seasonal factors

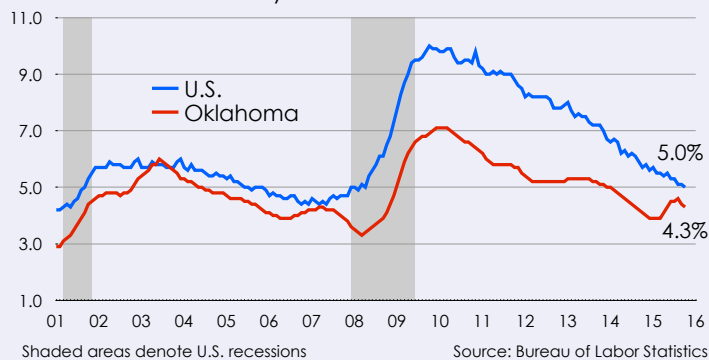
Source: OESC



Economic Indicators

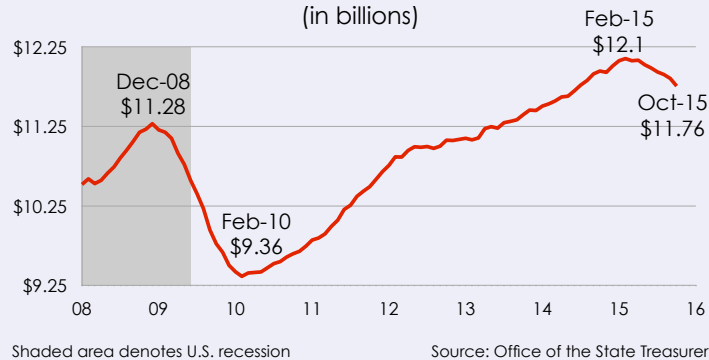
Unemployment Rate

January 2001 – October 2015



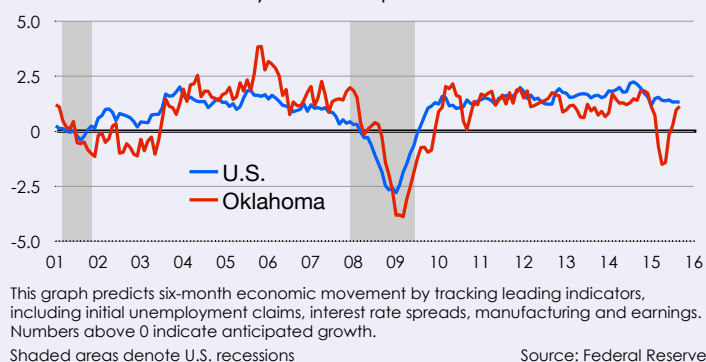
Oklahoma 12-Month Gross Receipts

January 2008 – October 2015
(in billions)



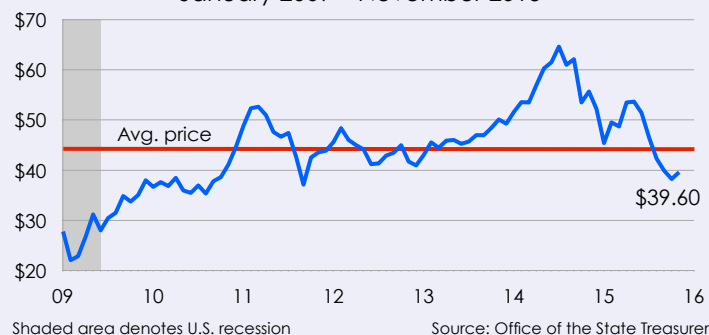
Leading Economic Index

January 2001 – September 2015



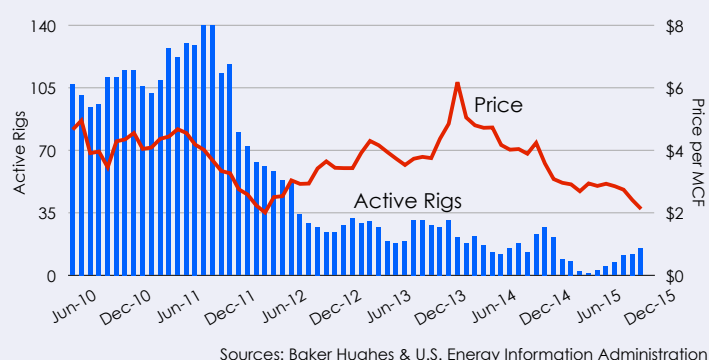
Oklahoma Stock Index

Top 23 capitalized companies
January 2009 – November 2015



Oklahoma Natural Gas Prices & Active Rigs

June 2010 – November 2015



Oklahoma Oil Prices & Active Rigs

June 2010 – November 2015

